

such election effective for transfers or distributions occurring on or after December 15, 1999, by attaching a statement to the partnership's return for such year. For the revocation to be valid, the statement must be filed not later than the time prescribed by § 1.6031(a)-1(e) (including extensions thereof) for filing the return for such taxable year, and must set forth the name and address of the partnership revoking the election, be signed by any one of the partners who is authorized to sign the partnership's federal income tax return, and contain a declaration that the partnership revokes its election under section 754 to apply the provisions of section 734(b) and 743(b). In addition, the following statement must be prominently displayed in capital letters on the first page of the partnership's return for such year: "RETURN FILED PURSUANT TO § 1.754-1(c)(2)."

[T.D. 6500, 25 FR 11814, Nov. 26, 1960, as amended by T.D. 7208, 37 FR 20686, Oct. 3, 1972; T.D. 8847, 64 FR 69916, Dec. 15, 1999; 65 FR 9220, Feb. 24, 2000]

§ 1.755-1 Rules for allocation of basis.

(a) *Generally.* A partnership that has an election in effect under section 754 must adjust the basis of partnership property under the provisions of section 734(b) and section 743(b) pursuant to the provisions of this section. The basis adjustment is first allocated between the two classes of property described in section 755(b). These classes of property consist of capital assets and section 1231(b) property (capital gain property), and any other property of the partnership (ordinary income property). For purposes of this section, properties and potential gain treated as unrealized receivables under section 751(c) and the regulations thereunder shall be treated as separate assets that are ordinary income property. The portion of the basis adjustment allocated to each class is then allocated among the items within the class. Adjustments under section 743(b) are allocated under paragraph (b) of this section. Adjustments under section 734(b) are allocated under paragraph (c) of this section.

(b) *Adjustments under section 743(b)*—(1) *Generally.* (i) For exchanges in

which the transferee's basis in the interest is determined in whole or in part by reference to the transferor's basis in the interest, paragraph (b)(5) of this section shall apply. For all other transfers which result in a basis adjustment under section 743(b), paragraphs (b)(2) through (b)(4) of this section shall apply. Except as provided in paragraph (b)(5) of this section, the portion of the basis adjustment allocated to one class of property may be an increase while the portion allocated to the other class is a decrease. This would be the case even though the total amount of the basis adjustment is zero. Except as provided in paragraph (b)(5) of this section, the portion of the basis adjustment allocated to one item of property within a class may be an increase while the portion allocated to another is a decrease. This would be the case even though the basis adjustment allocated to the class is zero.

(ii) *Hypothetical transaction.* For purposes of paragraphs (b)(2) through (b)(4) of this section, the allocation of the basis adjustment under section 743(b) between the classes of property and among the items of property within each class are made based on the allocations of income, gain, or loss (including remedial allocations under § 1.704-3(d)) that the transferee partner would receive (to the extent attributable to the acquired partnership interest) if, immediately after the transfer of the partnership interest, all of the partnership's property were disposed of in a fully taxable transaction for cash in an amount equal to the fair market value of such property (the hypothetical transaction).

(2) *Allocations between classes of property*—(i) *In general.* The amount of the basis adjustment allocated to the class of ordinary income property is equal to the total amount of income, gain, or loss (including any remedial allocations under § 1.704-3(d)) that would be allocated to the transferee (to the extent attributable to the acquired partnership interest) from the sale of all ordinary income property in the hypothetical transaction. The amount of the basis adjustment to capital gain property is equal to—

(A) The total amount of the basis adjustment under section 743(b); less

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(B) The amount of the basis adjustment allocated to ordinary income property under the preceding sentence; provided, however, that in no event may the amount of any decrease in basis allocated to capital gain property exceed the partnership's basis (or in the case of property subject to the remedial allocation method, the transferee's share of any remedial loss under § 1.704-3(d) from the hypothetical transaction) in capital gain property. In the event that a decrease in basis allocated to capital gain property would otherwise exceed the partnership's basis in capital gain property, the excess must be applied to reduce the basis of ordinary income property.

(ii) *Examples.* The provisions of this paragraph (b)(2) are illustrated by the following examples:

Example 1. (i) A and B form equal partnership PRS. A contributes \$50,000 and Asset 1, a nondepreciable capital asset with a fair market value of \$50,000 and an adjusted tax basis of \$25,000. B contributes \$100,000. PRS uses the cash to purchase Assets 2, 3, and 4. After a year, A sells its interest in PRS to T for \$120,000. At the time of the transfer, A's share of the partnership's basis in partnership assets is \$75,000. Therefore, T receives a \$45,000 basis adjustment.

(ii) Immediately after the transfer of the partnership interest to T, the adjusted basis and fair market value of PRS's assets are as follows:

	Assets	
	Adjusted basis	Fair market value
Capital Gain Property:		
Asset 1	\$25,000	\$75,000
Asset 2	100,000	117,500
Ordinary Income Property:		
Asset 3	40,000	45,000
Asset 4	10,000	2,500
Total	175,000	240,000

(iii) If PRS sold all of its assets in a fully taxable transaction at fair market value immediately after the transfer of the partnership interest to T, the total amount of capital gain that would be allocated to T is equal to \$46,250 (\$25,000 section 704(c) built-in gain from Asset 1, plus fifty percent of the \$42,500 appreciation in capital gain property). T would also be allocated a \$1,250 ordinary loss from the sale of the ordinary income property.

(iv) The amount of the basis adjustment that is allocated to ordinary income property is equal to (\$1,250) (the amount of the loss allocated to T from the hypothetical sale of the ordinary income property).

(v) The amount of the basis adjustment that is allocated to capital gain property is equal to \$46,250 (the amount of the basis adjustment, \$45,000, less (\$1,250), the amount of loss allocated to T from the hypothetical sale of the ordinary income property).

Example 2. (i) A and B form equal partnership PRS. A and B each contribute \$1,000 cash which the partnership uses to purchase Assets 1, 2, 3, and 4. After a year, A sells its partnership interest to T for \$1,000. T's basis adjustment under section 743(b) is zero.

(ii) Immediately after the transfer of the partnership interest to T, the adjusted basis and fair market value of PRS's assets are as follows:

	Assets	
	Adjusted basis	Fair market value
Capital Gain Property:		
Asset 1	\$500	\$750
Asset 2	500	500
Ordinary Income Property:		
Asset 3	500	250
Asset 4	500	500
Total	2,000	2,000

(iii) If, immediately after the transfer of the partnership interest to T, PRS sold all of its assets in a fully taxable transaction at fair market value, T would be allocated a loss of \$125 from the sale of the ordinary income property. Thus, the amount of the basis adjustment to ordinary income property is (\$125). The amount of the basis adjustment to capital gain property is \$125 (zero, the amount of the basis adjustment under section 743(b), less (\$125), the amount of the basis adjustment allocated to ordinary income property).

(3) *Allocation within the class*—(i) *Ordinary income property*. The amount of the basis adjustment to each item of property within the class of ordinary income property is equal to—

(A) The amount of income, gain, or loss (including any remedial allocations under § 1.704-3(d)) that would be allocated to the transferee (to the extent attributable to the acquired partnership interest) from the hypothetical sale of the item; reduced by

(B) The product of—

(I) Any decrease to the amount of the basis adjustment to ordinary income property required pursuant to the last sentence of paragraph (b)(2)(i) of this section; multiplied by

(2) A fraction, the numerator of which is the fair market value of the item of property to the partnership and the denominator of which is the total fair market value of all of the partnership's items of ordinary income property.

(ii) *Capital gain property*. The amount of the basis adjustment to each item of property within the class of capital gain property is equal to—

(A) The amount of income, gain, or loss (including any remedial allocations under § 1.704-3(d)) that would be allocated to the transferee (to the extent attributable to the acquired partnership interest) from the hypothetical sale of the item; minus

(B) The product of—

(I) The total amount of gain or loss (including any remedial allocations under § 1.704-3(d)) that would be allocated to the transferee (to the extent attributable to the acquired partnership interest) from the hypothetical sale of all items of capital gain property, minus the amount of the positive basis adjustment to all items of capital gain property or plus the amount of

the negative basis adjustment to capital gain property; multiplied by

(2) A fraction, the numerator of which is the fair market value of the item of property to the partnership, and the denominator of which is the fair market value of all of the partnership's items of capital gain property.

(iii) *Examples*. The provisions of this paragraph (b)(3) are illustrated by the following examples:

Example 1. (i) Assume the same facts as Example 1 in paragraph (b)(2)(ii) of this section. Of the \$45,000 basis adjustment, \$46,250 was allocated to capital gain property. The amount allocated to ordinary income property was (\$1,250).

(ii) Asset 1 is a capital gain asset, and T would be allocated \$37,500 from the sale of Asset 1 in the hypothetical transaction. Therefore, the amount of the adjustment to Asset 1 is \$37,500.

(iii) Asset 2 is a capital gain asset, and T would be allocated \$8,750 from the sale of Asset 2 in the hypothetical transaction. Therefore, the amount of the adjustment to Asset 2 is \$8,750.

(iv) Asset 3 is ordinary income property, and T would be allocated \$2,500 from the sale of Asset 3 in the hypothetical transaction. Therefore, the amount of the adjustment to Asset 3 is \$2,500.

(v) Asset 4 is ordinary income property, and T would be allocated (\$3,750) from the sale of Asset 4 in the hypothetical transaction. Therefore, the amount of the adjustment to Asset 4 is (\$3,750).

Example 2. (i) Assume the same facts as Example 1 in paragraph (b)(2)(ii) of this section, except that A sold its interest in PRS to T for \$110,000 rather than \$120,000. T, therefore, receives a basis adjustment under section 743(b) of \$35,000. Of the \$35,000 basis adjustment, (\$1,250) is allocated to ordinary income property, and \$36,250 is allocated to capital gain property.

(ii) Asset 3 is ordinary income property, and T would be allocated \$2,500 from the sale of Asset 3 in the hypothetical transaction. Therefore, the amount of the adjustment to Asset 3 is \$2,500.

(iii) Asset 4 is ordinary income property, and T would be allocated (\$3,750) from the sale of Asset 4 in the hypothetical transaction. Therefore, the amount of the adjustment to Asset 4 is (\$3,750).

(iv) Asset 1 is a capital gain asset, and T would be allocated \$37,500 from the sale of Asset 1 in the hypothetical transaction. Asset 2 is a capital gain asset, and T would be allocated \$8,750 from the sale of Asset 2 in the hypothetical transaction. The total amount of gain that would be allocated to T from the sale of the capital gain assets in the

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hypothetical transaction is \$46,250, which exceeds the amount of the basis adjustment allocated to capital gain property by \$10,000. The amount of the adjustment to Asset 1 is \$33,604 (\$37,500 minus \$3,896 (\$10,000×\$75,000/\$192,500)). The amount of the basis adjustment to Asset 2 is \$2,646 (\$8,750 minus \$6,104 (\$10,000×\$117,500/\$192,500)).

(4) *Income in respect of a decedent*—(i) *In general.* Where a partnership interest is transferred as a result of the death of a partner, under section 1014(c) the transferee's basis in its partnership interest is not adjusted for that portion of the interest, if any, which is attributable to items representing income in respect of a decedent under section 691.

See § 1.742-1. Accordingly, if a partnership interest is transferred as a result of the death of a partner, and the partnership holds assets representing income in respect of a decedent, no part of the basis adjustment under section 743(b) is allocated to these assets. See § 1.743-1(b).

(ii) The provisions of this paragraph (b)(4) are illustrated by the following example:

Example. (i) A and B are equal partners in personal service partnership PRS. As a result of B's death, B's partnership interest is transferred to T when PRS's balance sheet (reflecting a cash receipts and disbursements method of accounting) is as follows:

	Assets	
	Adjusted basis	Fair market value
Capital Asset	\$2,000	\$5,000
Unrealized Receivables	0	15,000
Total	2,000	20,000

	Liabilities and Capital	
	Adjusted per books	Fair market value
Capital:		
A	\$1,000	\$10,000
B	1,000	10,000
Total	2,000	20,000

(ii) None of the assets owned by PRS is section 704(c) property, and the capital asset is nondepreciable. The fair market value of T's partnership interest on the applicable date of valuation set forth in section 1014 is \$10,000. Of this amount, \$2,500 is attributable to T's share of the partnership's capital asset, and \$7,500 is attributable to T's 50% share of the partnership's unrealized receivables. The partnership's unrealized receivables represent income in respect of a decedent. Accordingly, under section 1014(c), T's basis in its partnership interest is not adjusted for that portion of the interest which is attributable to the unrealized receivables. Therefore, T's basis in its partnership interest is \$2,500.

(iii) At the time of the transfer, B's share of the partnership's basis in partnership assets is \$1,000. Accordingly, T receives a \$1,500 basis adjustment under section 743(b). Under this paragraph (b)(4), the entire basis adjustment is allocated to the partnership's capital asset.

(5) *Transferred basis exchanges*—(i) *In general.* This paragraph (b)(5) applies to

basis adjustments under section 743(b) which result from exchanges in which the transferee's basis in the interest is determined in whole or in part by reference to the transferor's basis in the interest. For example, this paragraph applies if a partnership interest is contributed to a corporation in a transaction to which section 351 applies or to a partnership in a transaction to which section 721(a) applies.

(ii) *Allocations between classes of property.* If the total amount of the basis adjustment under section 743(b) is zero, then no adjustment to the basis of partnership property will be made under this paragraph (b)(5). If there is an increase in basis to be allocated to partnership assets, such increase must be allocated to capital gain property or ordinary income property, respectively, only if the total amount of gain or loss (including any remedial allocations under § 1.704-3(d)) that would be

allocated to the transferee (to the extent attributable to the acquired partnership interest) from the hypothetical sale of all such property would result in a net gain or net income, as the case may be, to the transferee. Where, under the preceding sentence, an increase in basis may be allocated to both capital gain assets and ordinary income assets, the increase shall be allocated to each class in proportion to the net gain or net income, respectively, which would be allocated to the transferee from the sale of all assets in each class. If there is a decrease in basis to be allocated to partnership assets, such decrease must be allocated to capital gain property or ordinary income property, respectively, only if the total amount of gain or loss (including any remedial allocations under § 1.704-3(d)) that would be allocated to the transferee (to the extent attributable to the acquired partnership interest) from the hypothetical sale of all such property would result in a net loss to the transferee. Where, under the preceding sentence, a decrease in basis may be allocated to both capital gain assets and ordinary income assets, the decrease shall be allocated to each class in proportion to the net loss which would be allocated to the transferee from the sale of all assets in each class.

(iii) *Allocations within the classes—(A) Increases.* If there is an increase in basis to be allocated within a class, the increase must be allocated first to properties with unrealized appreciation in proportion to the transferee's share of the respective amounts of unrealized appreciation before such increase (but only to the extent of the transferee's share of each property's unrealized appreciation). Any remaining increase must be allocated among the properties within the class in proportion to the transferee's share of the amount that would be realized by the partnership upon the hypothetical sale of each asset in the class.

(B) *Decreases.* If there is a decrease in basis to be allocated within a class, the decrease must be allocated first to properties with unrealized depreciation in proportion to the transferee's shares of the respective amounts of unrealized depreciation before such decrease (but only to the extent of the transferee's

share of each property's unrealized depreciation). Any remaining decrease must be allocated among the properties within the class in proportion to the transferee's shares of their adjusted bases (as adjusted under the preceding sentence).

(C) *Limitation in decrease of basis.* Where, as the result of a transaction to which this paragraph (b)(5) applies, a decrease in basis must be allocated to capital gain assets, ordinary income assets, or both, and the amount of the decrease otherwise allocable to a particular class exceeds the transferee's share of the adjusted basis to the partnership of all depreciated assets in that class, the transferee's negative basis adjustment is limited to the transferee's share of the partnership's adjusted basis in all depreciated assets in that class.

(D) *Carryover adjustment.* Where a transferee's negative basis adjustment under section 743(b) cannot be allocated to any asset, because the adjustment exceeds the transferee's share of the adjusted basis to the partnership of all depreciated assets in a particular class, the adjustment is made when the partnership subsequently acquires property of a like character to which an adjustment can be made.

(iv) *Examples.* The provisions of this paragraph (b)(5) are illustrated by the following examples:

Example 1. A is a member of partnership LTP, which has made an election under section 754. The three partners in LTP have equal interests in capital and profits. Solely in exchange for a partnership interest in UTP, A contributes its interest in LTP to UTP in a transaction described in section 721. At the time of the transfer, A's basis in its partnership interest (\$5,000) equals its share of inside basis (also \$5,000). Under section 723, UTP's basis in its interest in LTP is \$5,000. LTP's only two assets on the date of contribution are inventory with a basis of \$5,000 and a fair market value of \$7,500, and a nondepreciable capital asset with a basis of \$10,000 and a fair market value of \$7,500. The amount of the basis adjustment under section 743(b) to partnership property is \$0 (\$5,000, UTP's basis in its interest in LTP, minus \$5,000, UTP's share of LTP's basis in partnership assets). Because UTP acquired its interest in LTP in a transferred basis exchange, and the total amount of the basis adjustment under section 743(b) is zero, UTP receives no special basis adjustments under

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section 743(b) with respect to the partnership property of LTP.

Example 2. (i) A purchases a partnership interest in LTP at a time when an election under section 754 is not in effect. The three partners in LTP have equal interests in capital and profits. During a later year for which LTP has an election under section 754 in effect, and in a transaction that is unrelated to A's purchase of the LTP interest, A contributes its interest in LTP to UTP in a

transaction described in section 721 (solely in exchange for a partnership interest in UTP). At the time of the transfer, A's adjusted basis in its interest in LTP is \$20,433. Under section 721, A recognizes no gain or loss as a result of the contribution of its partnership interest to UTP. Under section 723, UTP's basis in its partnership interest in LTP is \$20,433. The balance sheet of LTP on the date of the contribution shows the following:

	Assets	
	Adjusted basis	Fair market value
Cash	\$5,000	\$5,000
Accounts receivable	10,000	10,000
Inventory	20,000	21,000
Nondepreciable capital asset	20,000	40,000
Total	55,000	76,000
	Liabilities and Capital	
	Adjusted per books	Fair market value
Liabilities	\$10,000	\$10,000
Capital:		
A	15,000	22,000
B	15,000	22,000
C	15,000	22,000
Total	55,000	76,000

(ii) The amount of the basis adjustment under section 743(b) is the difference between the basis of UTP's interest in LTP and UTP's share of the adjusted basis to LTP of partnership property. UTP's interest in the previously taxed capital of LTP is \$15,000 (\$22,000, the amount of cash UTP would receive if LTP liquidated immediately after the hypothetical transaction, decreased by \$7,000, the amount of tax gain allocated to UTP from the hypothetical transaction). UTP's share of the adjusted basis to LTP of partnership property is \$18,333 (\$15,000 share of previously taxed capital, plus \$3,333 share of LTP's liabilities). The amount of the basis adjustment under section 743(b) to partnership property therefore, is \$2,100 (\$20,433 minus \$18,333).

(iii) The total amount of gain that would be allocated to UTP from the hypothetical sale of capital gain property is \$6,666.67 (one-third of the excess of the fair market value of LTP's nondepreciable capital asset, \$40,000, over its basis, \$20,000). The total amount of gain that would be allocated to UTP from the hypothetical sale of ordinary income property is \$333.33 (one-third of the excess of the fair market value of LTP's inventory, \$21,000, over its basis, \$20,000). Under paragraph (b)(5), LTP must allocate \$2,000 (\$6,666.67 divided by \$7,000 times \$2,100) of

UTP's basis adjustment to the nondepreciable capital asset. LTP must allocate \$100 (\$333.33 divided by \$7,000 times \$2,100) of UTP's basis adjustment to the inventory.

(c) *Adjustments under section 734(b)*—(1) *Allocations between classes of property*—(i) *General rule.* Where there is a distribution of partnership property resulting in an adjustment to the basis of undistributed partnership property under section 734(b)(1)(B) or (b)(2)(B), the adjustment must be allocated to remaining partnership property of a character similar to that of the distributed property with respect to which the adjustment arose. Thus, when the partnership's adjusted basis of distributed capital gain property immediately prior to distribution exceeds the basis of the property to the distributee partner (as determined under section 732), the basis of the undistributed capital gain property remaining in the partnership is increased by an amount equal to the excess. Conversely, when the basis to the distributee partner (as determined under section 732) of distributed capital gain property exceeds

the partnership's adjusted basis of such property immediately prior to the distribution, the basis of the undistributed capital gain property remaining in the partnership is decreased by an amount equal to such excess. Similarly, where there is a distribution of ordinary income property, and the basis of the property to the distributee partner (as determined under section 732) is not the same as the partnership's adjusted basis of the property immediately prior to distribution, the adjustment is made only to undistributed property of the same class remaining in the partnership.

(ii) *Special rule.* Where there is a distribution resulting in an adjustment under section 734(b)(1)(A) or (b)(2)(A) to the basis of undistributed partnership property, the adjustment is allocated only to capital gain property.

(2) *Allocations within the classes—(i) Increases.* If there is an increase in basis to be allocated within a class, the increase must be allocated first to properties with unrealized appreciation in proportion to their respective amounts of unrealized appreciation before such increase (but only to the extent of each property's unrealized appreciation). Any remaining increase must be allocated among the properties within the class in proportion to their fair market values.

(ii) *Decreases.* If there is a decrease in basis to be allocated within a class, the decrease must be allocated first to properties with unrealized depreciation in proportion to their respective amounts of unrealized depreciation be-

fore such decrease (but only to the extent of each property's unrealized depreciation). Any remaining decrease must be allocated among the properties within the class in proportion to their adjusted bases (as adjusted under the preceding sentence).

(3) *Limitation in decrease of basis.* Where a decrease in the basis of partnership assets is required under section 734(b)(2) and the amount of the decrease exceeds the adjusted basis to the partnership of property of the required character, the basis of such property is reduced to zero (but not below zero).

(4) *Carryover adjustment.* Where, in the case of a distribution, an increase or a decrease in the basis of undistributed property cannot be made because the partnership owns no property of the character required to be adjusted, or because the basis of all the property of a like character has been reduced to zero, the adjustment is made when the partnership subsequently acquires property of a like character to which an adjustment can be made.

(5) *Example.* The following example illustrates this paragraph (c):

Example. (i) A, B, and C form equal partnership PRS. A contributes \$50,000 and Asset 1, capital gain property with a fair market value of \$50,000 and an adjusted tax basis of \$25,000. B and C each contributes \$100,000. PRS uses the cash to purchase Assets 2, 3, 4, 5, and 6. Assets 4, 5, and 6 are the only assets held by the partnership which are subject to section 751. The partnership has an election in effect under section 754. After seven years, the adjusted basis and fair market value of PRS's assets are as follows:

	Assets	
	Adjusted basis	Fair market value
Capital Gain Property:		
Asset 1	\$ 25,000	\$ 75,000
Asset 2	100,000	117,500
Asset 3	50,000	60,000
Ordinary Income Property:		
Asset 4	40,000	45,000
Asset 5	50,000	60,000
Asset 6	10,000	2,500
Total	275,000	360,000

(ii) *Allocation between classes.* Assume that PRS distributes Assets 3 and 5 to A in complete liquidation of A's interest in the partnership. A's basis in the partnership interest

was \$75,000. The partnership's basis in Assets 3 and 5 was \$50,000 each. A's \$75,000 basis in its partnership interest is allocated between Assets 3 and 5 under sections 732(b) and (c).

A will, therefore, have a basis of \$25,000 in Asset 3 (capital gain property), and a basis of \$50,000 in Asset 5 (section 751 property). The distribution results in a \$25,000 increase in the basis of capital gain property. There is no change in the basis of ordinary income property.

(iii) *Allocation within class.* The amount of the basis increase to capital gain property is \$25,000 and must be allocated among the remaining capital gain assets in proportion to the difference between the fair market value and basis of each. The fair market value of Asset 1 exceeds its basis by \$50,000. The fair market value of Asset 2 exceeds its basis by \$17,500. Therefore, the basis of Asset 1 will be increased by \$18,519 (\$25,000, multiplied by \$50,000, divided by \$67,500), and the basis of Asset 2 will be increased by \$6,481 (\$25,000 multiplied by \$17,500, divided by \$67,500).

(d) *Effective date.* This section applies to transfers of partnership interests and distributions of property from a partnership that occur on or after December 15, 1999.

[T.D. 8847, 64 FR 69916, Dec. 15, 1999; 65 FR 9220, Feb. 24, 2000]

§ 1.755-2T Coordination of sections 755 and 1060 (temporary).

(a) *Coordination with section 1060—(1) In general.* If there is a basis adjustment to which this section applies—

(i) The fair market value of each item of partnership property must be determined under this section; and

(ii) The rules of § 1.755-1 must be applied using the values so determined.

(2) *Application of this section.* This section applies to any basis adjustment made under section 743(b) (relating to certain transfers of interests in a partnership) or section 732(d) (relating to certain partnership distributions), if assets of the partnership constitute a trade or business for purposes of section 1060(c).

(b) *Determining the fair market value of partnership property—(1) Property other than that in the nature of goodwill or going concern value.* For purposes of this section, the fair market value of each item of partnership property (other than property in the nature of goodwill or going concern value) shall be determined on the basis of all the facts and circumstances.

(2) *Property in the nature of goodwill or going concern value.* For purposes of paragraph (a) of this section, the fair market value of partnership property

in the nature of goodwill or going concern value (referred to hereinafter in this section as goodwill) shall be deemed to equal the amount (not below zero) which if assigned to such property would result in a liquidating distribution to the transferee partner equal to such partner's basis for the transferred partnership interest immediately after the transfer (reduced by the amount, if any, of such basis that is attributable to partnership liabilities) if—

(i) All partnership property were sold immediately after such transfer for an amount equal to the fair market value of such property (as determined under this section), and

(ii) The proceeds of that sale were, after the payment of all partnership liabilities (within the meaning of section 752 and the regulations thereunder), distributed to the partners.

(c) *Cross-reference.* See §§ 1.732-1(d)(3) and 1.743-1(b)(3) for rules requiring a transferee partner to attach a statement to such partner's return showing the computation of the special basis adjustment and the partnership properties to which the adjustment is allocated under section 755.

(d) *Effective date.* This section applies to any basis adjustment under section 743(b) made as a result of any transfer of a partnership interest made after May 6, 1986, unless such transfer is made pursuant to a binding contract that was in effect on May 6, 1986, and at all times thereafter prior to such transfer. However, the requirements of this section shall be deemed to be satisfied with respect to any transfer made on or before July 15, 1988, if the amount of any basis adjustment under section 743(b) or section 732(d) made as a result of such transfer that is allocated to each item of partnership property (other than goodwill) does not exceed the amount equal to the difference between the transferee partner's share of the partnership basis of such property and such partner's share of the fair market value of such property.

(e) *Example.* The provisions of this section may be illustrated by the following example which assumes that the assets of the partnership constitute a trade or business under section 1060